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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Is Economic Weakness Exaggerated?

As the economy crosses into the new year, there are not only plenty of signs that its once robust vigor has ebbed, there is hardly an analyst astir who does not foresee even slower growth and lower short-term interest rates ahead. Nor does such a view seem unreasonable, especially when you consider that automobile sales have plunged to the lowest levels since the last recession, construction is languishing, initial claims for state unemployment insurance are rising and factory jobs are contracting. Even the Federal Reserve seems to have been swayed by the pundits' prevailing opinion. At its mid-December, policy-setting Federal Open Market Committee meeting, the central bank apparently again decided to ease its grip on the monetary reins—by some counts, for the sixth time last year—driving the Federal funds rate lower by another one quarter of one percent to 8¼ percent. And, if you care to believe the majority, another easing move could be near.

Although prospects for additional monetary ease still appear bright, a word of caution is in order. At this juncture, it would be unwise for the bond crowd to rule out entirely the possibility of a snapback in economic growth early this year for several reasons. For one thing, despite the barrage of negative economic statistics which sparked the latest easing action, there are some which point in the other direction. For another, although the manufacturing sector is widely assumed to be stuck in neutral, today's lethargy is a far cry from four years ago, when manufacturing was again at the epicenter of a similar recession scare. And, just as during that time, the Fed has shifted policy, sending interest rates declining along with the dollar. This is precisely the same combination that touched off the manufacturing-led growth spurt of the past 2½ years—and kept it going after the equity market "meltdown" of October 1987. If history repeats itself, the principal risk to the standard forecast of slower growth and lower interest rates in the months ahead may not be recession but faster growth—and rising interest rates.

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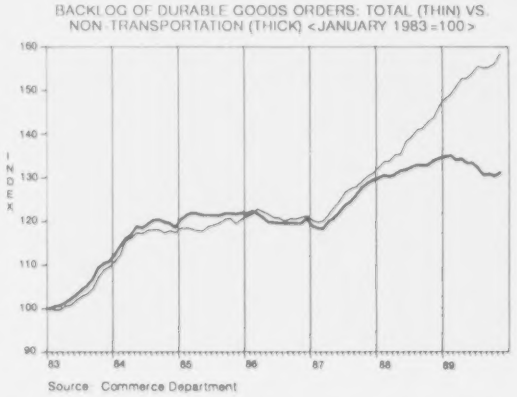
Take, for example, the latest batch of economic statistics. While it is virtually impossible to determine meaningful trends from just one month's number, notwithstanding the claims of market "watchers" to the contrary, it would seem reasonable that if the economy was in the process of unraveling, most—if not all—economic indicators would be either falling or, at best, treading water. Yet, in recent weeks, there



have been a number of seemingly upbeat reports, ranging from anecdotal evidence of a good Christmas selling season, hefty gains in payroll employment and personal income, a sizable increase in factory orders and shipments, and further growth in already bulging order backlogs. Although total employment growth has moderated and industrial output has flattened, the implications of these developments are not entirely negative, since they do tend to keep a lid on wages and, by extension, inflation.

Industry's Strengths

Some of the same question marks surround the health of manufacturing in particular. By some yardsticks, today's industry downturn is far less severe, and perhaps more readily reversible, than it was in 1985-86, when the energy industry plumbed new depths of despair, industrial exports were shrinking and a large chunk of the nation's heartland was being casually written off as an unsalvageable "rust belt". Of most concern are the 164,000 factory jobs lost since March. However, this is not only far from the 600,000 jobs shed in 1985-86, but it is much more concentrated. Fully one-third of the jobs lost last year were directly attributable to the drop in new-car sales, whereas in 1985-86, the

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job losses were widely diffused, with the auto industry accounting for only four percent. And, while more cuts are undoubtedly in the offing, there's still a long way to go before reaching 600,000, and it looks like the bulk will again be auto industry layoffs.

Other pronounced differences exist, making for a less than bleak outlook. Order backlogs, for example, are a third bigger today than three years ago and are rising, whereas they were flat in 1985-86. To be sure, while commercial aircraft represents a sizable portion of the total, this is probably more of a stabilizing strength, than a lurking weakness, as some suggest. In light of airline deregulation here, and on tap in Europe, not to mention the unquestionable need to replace vast numbers of aged jets, long-dated aircraft orders may well be less prone to the sudden cancellations which have plagued capital goods producers at the first hint of an economic downturn in the past. What is more, industrial exports are booming, and should continue to do so in light of the strong economic growth prospects prevailing overseas.

A Repeat Policy Response

Indeed, bulging backlogs and exports go to the heart of the difference in the degree of weakness affecting manufacturing now compared

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/13/89)	217,158	- 584	+ 21,203
New York City (12/13/89)	41,534	- 207	+ 290
Commercial Paper (12/13/89)	521,156	+ 1,926	+ 73,658

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/13/89)	318,109	+ 241	+ 18,014
New York City (12/13/89)	60,330	+ 549	+ 5,423

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/13/89)	994,297	+ 75	+ 81,632
New York City (12/13/89)	184,404	+ 1,330	+ 10,047

Financial Markets

	Thursday 12/28/89	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.91%	+ .09	- .41
180-Day Bills†	7.93	+ .10	- .72
Longest Bills†	7.74	+ .05	- 1.28
Recent Issues:			
7⅛s 12/31/90 (When Issued)	7.87	+ .14	
7⅛s 12/31/93 (When Issued)	7.84	+ .10	
7⅞s 11/15/99	7.90	+ .10	
8⅛s 8/15/19	7.96	+ .09	
Municipals:			
Bond Buyer—20 Bond Index* (12/28/89)	6.97%	+ .01	- .60
Blue List Total ($ Million)	$1,525	+ $ 23	+ $439
30-Day Visible Supply ($ Million)	$1,177	+ $ 122	- $ 1
Total	$2,702	+ $ 145	+ $438
Corporates:			
Moody's Aa Composite (12/28/89)	9.13	+ .05	- .71
30-Day Visible Supply ($ Million)	$1,910	+ $1,250	+ $328
Stocks:			
Dow-Jones Averages:			
Industrials	2,732.30	+ 41.17	+549.08
Transportation	1,174.43	+ 30.76	+203.38
Utilities	235.41	+ 2.01	+ 49.24
65 Stocks	1,030.16	+ 17.70	+200.76
N.Y.S.E. Composite Index	193.58	+ 3.08	+ 36.77
N.Y.S.E. Avg. Daily Vol. for Week (000's)	113,533	- 54,355	+16,256

*34% Taxable equivalent 10.56%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Thursday 12/28/89	Week Ago
Overnight	9.50%	8.19%
1 month	8.38	8.63
3 month	8.25	8.38
6 month	8.19	8.13
1 year	8.13	8.00

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/28/89)	Currency Per U.S. $	Week Ago
Belgium	35.35	36.26
Canada	1.1587	1.1589
France	5.7475	5.8560
Germany	1.6875	1.7135
Italy	1261.50	1280.00
Japan	142.45	143.25
Mexico	2646.00	2640.00
Netherlands	1.8975	1.9485
South Korea	677.90	676.60
Switzerland	1.5315	1.5490
Taiwan	26.17	26.15
U.K.*	1.6172	1.6190

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (12/28/89) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	-0.2%	-3.8%

with the mid-1980s. In 1985-86, industry was experiencing deep-seated, systemic difficulties associated with the protracted overvaluation of the dollar in the foreign exchange markets and the sudden free fall in energy prices, both of which took years to overcome. Today's travail, in contrast, is less deeply rooted, and more quickly remedied, a reflection of the monetary restraint of 1988, and the success of domestic auto manufacturers in convincing consumers to bunch their purchases of 1990 model year vehicles in the late summer of 1989. While no one has yet figured out a way to jump-start auto sales, the period of monetary restraint is being reversed.

Three years ago, the combination of interest rate relief and dollar depreciation sparked strong economic growth in 1987-88. More recently, the Federal funds rate has declined from a peak of nearly ten percent last April, to around 8¼ percent today. At the same time, the dollar has retreated from a level that had been above two Deutschemarks to below 1.70 marks. This same prescription rejuvenated the economy in the past, and while the end result may not turn out to be the same, the policy approach is *deja vu*—one reason for the hesitancy with which the Fed has loosened its monetary grip, and the justifiable caution with which portfolio managers should view the bond market.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/20/89	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	229.385	- .662	- 12.704
Loans to Depository Inst.	.189	+ .057	- 1.143
Float	1.310	+ .477	- .457
Total Reserve Bank Credit	267.553	- .157	+ 3.647
Treasury Deposits with Federal Reserve Banks	4.402	- .073	- 2.060
Currency in Circulation	256.683	+ 1.334	+12.371
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	232.269	- 1.443	- 3.329
Member Bank Reserves:	**12/13/89**		
Total Reserves Held	60.640	+ 1.000	- 1.566
Excess (Deficiency)	.770	- .239	- .206
Net Free Reserves	.641	+ .050	+ .150

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (12/18/89)	795.7	+ 7.5	+ 0.4
M2 (12/18/89)	3,215.6	+ 7.8	+ 4.6
M3 (12/18/89)	4,036.6	+ 3.2	+ 3.3
Domestic Nonfinancial Debt (3rd Q'89)	9,604.5	+ 7.5	+ 8.2

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 12/28/89	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.72%	7.58%	7.28%
* Federal Agencies	8.05	7.95	7.85
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.52	8.71	8.71
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.29	8.20	8.07

‡ Finance Company Paper–Prime

5- 14 days	9.07%
15- 29 days	8.60
30- 59 days	8.28
60- 89 days	8.15
90-179 days	7.90
180-239 days	7.50
240-270 days	7.50

‡* Bankers' Acceptances

Jan.	9.25%
Feb.	8.55
Mar.	8.28
Apr.	8.15
May	8.05
Jun.	7.92

‡ Industrial Paper–Prime

30- 89 days	8.58%
90-120 days	8.23

†Federal Funds Effective Rate 9.50%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'89	$ 5,281 r	$ 5,202	$ 4,927
Gross National Product (1982 Dollars)*	3rd Q'89	$ 4,163 r	$ 4,133	$ 4,043
Percent Change, Annual Rate	3rd Q'89	3.0 r	2.5	3.2
Change in Consumer Prices*	Nov '89n	4.8%	6.0%	3.6%
Change in MH Cost of Living Index*	Nov '89n	4.8%	7.2%	2.4%
Change in Producer Prices*	Nov '89	- 1.2%	4.8%	3.6%
Civilian Employment (Thousands of Persons) †	Nov '89	117,786	117,545	115,947
Unemployment as % of Civilian Labor Force †	Nov '89	5.4%	5.3%	5.4%
Personal Income*	Nov '89n	$ 4,541	$ 4,503r	$ 4,169
Leading Indicators Composite Index (1967=100) †	Oct '89	144.8	145.2	144.0
Industrial Production Index (1977=100) †	Nov '89	141.5	141.3	139.9
Net Change in Consumer Installment Credit †	Oct '89	$ 3.34	$ 1.37	$ 2.58
U.S. Merchandise Trade Balance †	Oct '89	- $ 10.20	- $ 8.51	- $ 9.23
Plant and Equipment Expenditures*	1st Q'90n	$ 503.5	$ 485.5r	$ 459.5
Private Housing Starts (Thousands of Units)*	Nov '89n	1,361	1,428r	1,567
New Construction Expenditures*	Oct '89	$ 420.1	$ 415.9	$ 411.1
Total Business Inventories †	Oct '89	$ 793.9	$ 790.6	$ 743.0
Total Business Sales †	Oct '89	$ 519.2	$ 522.8	$ 498.6

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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